

Guidance and Detailed Procedures

Sub-granting CDBG Funds to Non-Profit Corporations, including De-federalization of Future CDBG Loan Repayments

PURPOSE OF THIS GUIDANCE:

The purpose of this guidance is inform State CDBG grantees how to: 1) sub-grant CDBG funds to eligible non-profit corporations (sub-grantees) to carry out certain activities, and; 2) exempt loan repayments from being considered CDBG Program Income (PI).

Under a sub-grant agreement, the grantee may allow a sub-grantee to carry out only CDBG-eligible activities that fit within one of the following three activity categories:

- Part of a local neighborhood revitalization project;
- Community economic development, or;
- An energy conservation project.

Grantees are prohibited from sub-granting any activity that does not fit into one of these activity categories.

The sub-grant agreement may allow the sub-grantee to use the CDBG funds to make loans to eligible recipients under the usual rules governing CDBG activities. The resulting loan repayments to the sub-grantee, however, would not necessarily be considered program income subject to federal or State CDBG requirements. However, the Grantee is allowed and strongly encouraged to condition the sub-grant on the continued reuse of repaid funds in the community, preferably for the same activity. We will refer to this procedure as de-federalization because the loan repayments would lose their federal identity.

HISTORY:

Under the State CDBG Program, many grantees choose to provide CDBG funds to nonprofit corporations to administer CDBG activities. Some of these activities have included the making of loans. The grantee, rather than the nonprofit corporation, has typically been the beneficiary of such loans. Grantees have typically designated the nonprofit corporations as “subrecipients” rather than “sub-grantees”, whether or not the activity fit under the above three activity categories or included the making of loans. The subrecipient option is still available when the grantee wishes to have a non-profit corporation carry out many CDBG activities. However, it cannot be used for carrying out an activity that is eligible only if carried out by a nonprofit corporation, such as housing new construction, or whenever loan repayment de-federalization is desired.

Section 105(a)(15) of the federal Housing and Community Development Act of 1974 allows nonprofit corporations to directly undertake certain CDBG activities. Use of this section requires the grantee to designate the non-profit corporation as a “sub-grantee”. 24 CFR 570.489(e)(2)(ii) of the federal CDBG regulations exempts from the definition of program

income amounts generated by activities eligible under Section 105(a)(15) of the Act and *carried out by* (nonprofit corporations).

In 2002 HUD published its Guide to National Objectives and Eligible Activities for State CDBG Program. This guide, intended for use by states, reiterates the rules contained in federal regulation and law beginning on page 2-70. Page 2-76 includes an explanation of the concept we are referring to as de-federalization. In October of 2004 HUD published Notice CPD 04-11 to clarify various state duties and responsibilities in regard to program income. Section IV of this notice includes the statement, "States seeking to minimize the amount of funds that must be treated as program income could take advantage of this exemption by encouraging UGLGs (Units of General Local Government) to form sub-grantee relationships with nonprofit corporations to administer Revolving Loan Funds (RLFs)." California's State CDBG Grantees may be unaware of the option to sub-grant many of their CDBG-funded lending activities to nonprofit corporations and de-federalize loan repayments. Yet, many are struggling with the complexity of operating several CDBG-funded programs simultaneously and some have large program income balances that may cause them to be held out from applying for new CDBG grants.

GOALS:

The State CDBG Program has the following goals of allowing the sub-granting of CDBG funds, and loan repayment de-federalization:

- A. To decrease the administrative burden on local governments to stay in compliance with CDBG requirements over time.
- B. To begin the use of sub-grant agreements whenever non-profit corporations undertake housing new construction or any other activity that is CDBG-eligible only if carried out by non-profit corporations.
- C. To increase flexibility in the administration of lending programs serving projects that are associated with neighborhood revitalization, economic development, or energy conservation.
- D. To increase the capacity of nonprofit corporations to administer a wide variety of CDBG-eligible activities, including direct lending programs.
- E. To encourage the development of various model lending programs that can be replicated for other activities and in other areas of the state.
- F. To maximize flexibility of use of CDBG funds, including accommodating regional approaches to the administration of lending programs.

EXECUTIVE SUMMARY:

After a State CDBG grantee complies with the following rules and procedures, it may sub-grant State CDBG funds to an eligible non-profit corporation to carry out the approved activity. The sub-grant agreement may allow the de-federalization of loan repayments. The following is a brief synopsis of the process of sub-granting CDBG funds to a nonprofit corporation:

1. **Eligible Activity.** The sub-granted activity must be related to neighborhood revitalization, economic development or energy conservation. For activities that are part of a neighborhood revitalization project (NRP) additional documentation will be required.
2. **Funding.** The sub-granted activity may be funded with CDBG open grant funds or local Revolving Loan Account (RLA) CDBG program income funds.

3. **CDBG Approval.** The grantee and the sub-grantee must complete and certify the Determination of Eligibility of Sub-Grantee form, Exhibit A, attached. A separate form is required for each activity that the grantee wishes to sub-grant. IRS documentation that the non-profit corporation is a 501(c)(3) corporation, and NRP documentation as described in 1., above, must be submitted. The Determination of Eligibility of Sub-grantee form must be approved by the State CDBG Program prior to carrying out the activity.
4. **Grantee Responsibility.** The grantee will be responsible for all federal CDBG compliance requirements and will be monitored by the State for the initial use of CDBG open grant or PI funds.
5. **Sub-grantee Responsibility.** The sub-grantee will be responsible for “carrying out” the sub-granted activity. This primarily means it will undertake the activity directly or through contracts with an entity other than the grantee.
6. **Sub-grant Agreement.** The grantee and the sub-grantee enter into a sub-grant agreement meeting, at a minimum, the usual CDBG contract requirements, as well as addressing the sub-grantee’s reuse of repaid funds, including whether or not the repaid funds will be considered to be CDBG PI. This agreement may sub-grant one activity to the sub-grantee utilizing one or more sources of CDBG funds. If de-federalization is proposed, the sub-grant agreement must be approved by CDBG in advance of the sub-grantee carrying out the activity.
7. **Citizen Participation.** Citizen participation requirements will apply to the sub-granting of CDBG funds. Requirements include public notice, public hearing, and passage of a governing body resolution concerning the arrangement with the sub-grantee including a stipulation regarding the PI vs. de-federalization status of any loan repayments.
8. **Program Management.** The grantee may assist the sub-grantee to develop or prepare such program master documents and procedures as may be needed. It is anticipated that the grantee would use CDBG funds to pay the reasonable costs of undertaking the initial, CDBG funded, activity, including the making of any initial loans.
9. **Reporting of Expenditures.** The initial expenditures of sub-granted funds are reported in the usual ways by the grantee.

DETAILED RULES AND PROCEDURES:

1. **Eligible Activity.** Grantees are permitted to sub-grant to non-profit corporations only activities that fall under the following three activity categories: A) Programs or projects that are Part of a neighborhood revitalization project; B) Community economic development projects; and C) Energy conservation projects. When the sub-grant is used by the non-profit corporation to make loans then the repayments of the loans may be de-federalized. The following are **examples of activities**, organized by the three eligible activity categories that may be appropriate for sub-granting and de-federalization:
 - A. **Part of a Neighborhood Revitalization Project (NRP).** In order to sub-grant any activity under the NRP category, the program or project must be associated with the Grantee’s efforts to revitalize either the entire community (an entire city/town or unincorporated community with 25,000 or less population), or a designated geographic target area within the jurisdiction (for a larger city or unincorporated

community.) A NRP for a designated geographic target area must be established by the governing body of the jurisdiction as a redevelopment target area or other official geographic target area designation. The Determination of Eligibility of Sub-grantee form (Exhibit A) must be accompanied by documentation of the establishment of the geographic target area (including a geographic description), if applicable, and a description of how the project benefits the NRP.

- i. **Rehabilitation of single family housing** occupied by low and moderate income (below 80% of AMI) households;
 - ii. **Rehabilitation of investor-owned housing** occupied by low and moderate income (below 80% of AMI) households and meeting CDBG affordability rules;
 - iii. **Homeownership assistance** for purchase of existing single family housing to be occupied by low and moderate income (below 80% of AMI) households; and
 - iv. **Development of new single family housing** including the subsequent roll over of CDBG development funds into homeownership assistance for purchase of the housing to be occupied by low and moderate income (below 80% of AMI) households;
- B. Community Economic Development Program. This activity is typically a **loan fund program for local business start-ups and expansions** in which at least 51 percent of the new or retained jobs will be held by low and moderate income (below 80% of AMI) persons.
- C. Energy Conservation Program. An activity that is clearly designed to conserve energy for the benefit of residents within the grantee's jurisdiction. An example of this type of program may involve the **construction of energy efficient housing** where substantial savings in heating and/or cooling costs are expected to be realized.

2. Funds. A Grantee may sub-grant to qualifying non-profit corporation CDBG open grant funds and/or program income funds, as follows:

- a. **Grant Funds.** A Grantee may sub-grant any of the activities listed in 1.A, 1.B, or 1.C, above, if the activity is authorized under an open CDBG grant;
- b. **Program Income Funds.** A Grantee that has CDBG program income may sub-grant those funds as follows:
 - 1) **PI on Open Grant-funded Activity.** A Grantee may augment open grant-funded activities (as in 2.A., above) with program income funds. The governing body of the grantee would commit the PI funds and specify the source of the PI as either from an RLA or from future program income. If specifying RLA funds, they would be transferred out of the RLA and into a PI fund associated with the open grant funds. If committing future program income, upon receipt the program income it would be deposited into a PI fund associated with the grant funds. In this case all repayments, whether the loans were funded by open grant funds or PI funds, could be de-federalized. The sub-grantee's initial use of these funds must meet all CDBG requirements and cannot be de-federalized until repaid to the sub-grantee; and
 - 2) **PI on Revolving Loan Account (RLA) Activity.** A Grantee that has an approved PI Reuse Plan containing one or more RLAs may sub-grant some or all of the RLA funds to the sub-grantee to carry out a qualifying RLA activity, per 1., above. The sub-grantee's initial use of these funds

must meet all CDBG requirements and cannot be de-federalized until repaid to the sub-grantee. The grantee may report, on its Annual PI Report, the sub-grantee's initial lending of RLA funds as "revolving expenditures" in the year they are lent, even if the funds are to be repaid to the sub-grantee and are not be returned to the RLA.

- 3. CDBG Approval/Eligibility of the Sub-Grantee** The sub-grantee must meet the requirements of 105(a)(15) of the Housing and Community Development Act. For each activity to be sub-granted, the grantee and prospective sub-grantee will be required to complete and submit for State CDBG Program approval, one Determination of Eligibility of Sub-grantee form (Exhibit A, attached), indicating that the following requirements related to the eligibility of the selected activity and sub-grantee have been met:

 - a. The non-profit corporation is organized under Statute 501(c)(3); its Internal Revenue Service documentation is attached, and; it is organized under State or local law to serve the community development needs of communities such as the grantee.
 - b. The non-profit corporation will be "carrying out" the specified activity (see 5., below).
 - c. In order for loan repayments to become de-federalized, the sub-grantee will be the beneficiary of the loans, and CDBG will approve the sub-grant agreement in advance of the activity being carried out.

The activity shall not be carried out until CDBG has signed the Determination of Eligibility of Sub-grantee form.
- 4. Responsibilities of the Grantee** The grantee is responsible for certifying the sub-grantee's eligibility (see #3, above) and for compliance with all federal CDBG requirements. The State will monitor the grantee, not the sub-grantee, for the initial use of CDBG funds including grant and program income funds and the grantee will be responsible for obtaining any necessary records from the sub-grantee. The grantee will be responsible for certifying the eligibility of the proposed activity under Section 105(a)(15) of the HCDA. The grantee selects (not subject to federal procurement rules) the non-profit corporation to carry out the activity and designates it as a sub-grantee using a sub-grant agreement.
- 5. Responsibilities of the Sub-grantee** The sub-grantee will be responsible for "carrying out" the CDBG-funded program within the meaning of the federal CDBG entitlement regulations, 24 CFR 570.204(a)(4). According to this regulation, "carry out" primarily means it will undertake the activity directly or through contracts with an entity other than the grantee. The sub-grantee will be responsible for these minimum activities in carrying out the program:

 - a. Owner of all program policies and processes for the implementation of the program, and;
 - b. To manage the program. If the sub-grantee does not have adequate staffing to manage the program it can contract for these services with a private contractor. A solicitation process for the contractor shall be conducted in accordance with the sub-grantee's procurement policy. These services may include but are not limited to performing the daily accounting, application processing, and construction management duties, and;
 - c. To be in control of all decisions regarding the sub-granted CDBG funds, including final loan decisions (if applicable), and;

- d. Compliance with all federal and state lending requirements, and;
- e. Owner of the resulting loans and loan repayments (if applicable), and;
- f. To use any repaid funds as specified by the grantee in the sub-grant agreement. If for some reason the sub-grantee dissolves and an asset reversion occurs, contact the State of California for assistance. An asset reversion could change the federal identity of any repaid funds; and
- g. Final accountability for all CDBG funds received.

6. Sub-Grant Agreement No formal procurement process is required for the selection of a sub-grantee. The grantee negotiates terms with its selected sub-grantee, drafts a "Sub-grant Agreement" that is mutually acceptable and that meets CDBG contract requirements, and submits the draft agreement to CDBG for review and written approval. The sub-grant agreement must meet the usual CDBG contract requirements as contained in CDBG Grant Management Manual, Chapter 12 Monitoring, Checklist 10 Procurement, #3 Contractors and Subcontractors, Subrecipients and OGEs. In order to de-federalize the repayment of loans to be made under the sub-grant agreement, it must clearly state the conditions of the sub-grantee's use of the repaid funds, such as for the same activity, in the same community, for the same clientele group, and the sub-grant agreement must be approved by CDBG in advance of the sub-grantee carrying out the activity. All federal CDBG compliance requirements pertain to the initial use of sub-granted CDBG grant and/or program income funds and remain the obligation of the grantee.

Important Note: Although the repaid funds may no longer be program income subject to CDBG requirements, grantees are strongly encouraged to establish, through their sub-grant agreements with the sub-grantees, requirements for re-use of the funds. The State CDBG Program encourages grantees to require continuation of the same activity in the community to assist low-income households. The grantee is also encouraged to require program performance reports and the return of repaid funds if agreement conditions are not met.

7. Citizen Participation The grantee is required to hold a properly noticed citizen participation public hearing and pass a resolution approving the arrangement with the sub-grantee. Such notice and resolution must include whether or not any loan **repayments would be retained by the sub-grantee, and whether or not such loan** repayments would be program income subject to the jurisdiction's program income reuse plan.

8. Program Management The grantee may assist the sub-grantee to develop or prepare such items as; application procedures, process applications, notices of loan approvals, filing of deeds of trust, construction inspection/oversight, verification of program eligibility, owners certifications and other such documents as may be needed. It is anticipated that the grantee would pay, through open grant or PI funds, the reasonable costs of making the initial loans, but the sub-grantee's subsequent costs of making and servicing loans made with defederalized funds would be born by the sub-grantee and funded through the repayments of its de-federalized loans.

9. Reporting of Expenditures. The initial expenditures of any PI funds slated for de-federalization are reported in the usual way.

The expenditure of sub-granted grant funds are reported on the grant's Financial and Accomplishment Reports and Funds Request forms.

The expenditure of sub-granted program income is reported on the Annual Program Income Report form and on Funds Requests if the PI has been committed to an open grant activity. The expenditure of PI Revolving Loan Account (RLA) funds on loans may be reported as "revolving" expenditures on the Annual PI report even though they will not be repaid to the RLA. Non- revolving expenditures, including general administration, activity delivery and the making of grants are reported as non-revolving expenditures, as usual. The sub-grantee's income and expenditure of de-federalized loan repayments are not considered PI, and shall not be reported on future CDBG PI or other report forms.

EXHIBIT A

Determination of Eligibility of Sub-Grantee

Under the Federal Housing and Community Development Act of 1974, Section 105(a)(15)

State of California, Community Development Block Grant Program

Grantee (City or County) Name: _____; For Open Grant No. (if applicable): _____

Sub-grantee (Nonprofit) Name: _____

Name of the Revolving Loan Account or
Open Grant Activity (as applicable) proposed for Sub-grant: _____

"Yes" responses are required for approval. Exceptions are: Check only one in #4; #6 may be N/A.

- 1) Do the grantee and sub-grantee agree to enter into a sub-grant agreement meeting the agreement content requirements found in the CDBG Grant Management Manual, Chapter 12 Monitoring, Checklist 10 Procurement, #3 Contractors and Subcontractors, Subrecipients and OGEs?
☐ Yes ☐ No
- 2) Regarding the proposed sub-grantee:
 - a) Is it a nonprofit corporation organized under U.S. Statute 501(c)(3)? ☐ Yes ☐ No
 - b) Is a copy of its Internal Revenue Service (IRS) documentation attached? ☐ Yes ☐ No
 - c) Is it an eligible nonprofit under 105(a)(15) of the Housing and Community Development Act of 1974 as amended, meaning that it is organized (under State or local law) to serve the community development needs of non-entitlement communities such as the grantee?
☐ Yes ☐ No
- 4) The proposed activity is (check Yes on only one):
 - a) Part of a neighborhood revitalization project (attach documentation); or ☐ Yes ☐ No
 - b) Community economic development; or ☐ Yes ☐ No
 - c) An energy conservation project. ☐ Yes ☐ No
- 5) Will the sub-grantee be "carrying out" the activity, meaning it will undertake the activity directly or through contracts with an entity other than the grantee? Note: Refer to the Department's Detailed Rules and Procedures for further guidance on what it means to be "carrying out" the activity.
☐ Yes ☐ No
- 6) If de-federalization of repayments from loans made using the sub-granted funds is proposed:
 - a) Does the sub-grant agreement authorize sub-grantee to be beneficiary of the loans, retain loan repayments, and does it specify terms of reuse of the repayments? ☐ Yes ☐ No ☐ N/A
 - b) Has the proposed sub-grant agreement been approved in writing by CDBG; is it attached?
☐ Yes ☐ No ☐ N/A

Certification: *I certify, to the best of my knowledge, that the information above and within the attachments is correct.*

Signature of Grantee's Authorized Official: _____ Date: _____

Name of Grantee's Authorized Official: _____

Signature of Sub-grantee's Authorized Official: _____ Date: _____

Name of Sub-grantee's Authorized Official: _____

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Approval of HCD CDBG Representative: _____ Date: _____

Name of HCD CDBG Representative: _____